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# Rethinking the Fundamentals:



# Provincial-Local Finances in the Greater Toronto Area

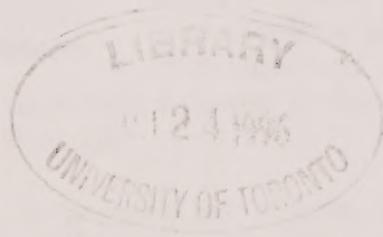
Greater Toronto Co-ordinating Committee (GTCC)

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The Greater Toronto Co-ordinating Committee (GTCC) was established by the Province in 1988 and is made up of senior officials appointed by the Council of each municipality within the GTA, together with senior staff from the provincial office of the Greater Toronto Area (OGTA) and other provincial Ministries. The GTCC is co-chaired by a municipal and provincial representative and support is provided by the OGTA.

The mandate of the GTCC is to identify or examine issues and trends that may have a major effect on the quality of life, social equity and economic vitality of the GTA and make recommendations for action.

The GTCC, through various subcommittees, is investigating and has or will be reporting on: municipal financing, economic development, quality of life, telecommunications, infrastructure, municipal structure, and assessment delivery.





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# Rethinking the Fundamentals: Provincial-Local Finances in the Greater Toronto Area

## 1. Testing Economic and Fiscal Perceptions About the GTA

This study, examining Greater Toronto Area (GTA) financing issues, is one of several studies commissioned by the Greater Toronto Co-ordinating Committee (GTCC) to investigate important issues affecting the economic health and quality of life in the GTA.

The GTA is generally acknowledged to be the "engine" of the Ontario economy. The historical economic dynamism of the GTA has generated a long-standing perception that GTA taxpayers have an unlimited ability to supply a significant portion of the fiscal resources necessary to provide key public services and infrastructure in other regions of the Province. This type of fiscal redistribution is part and parcel of the reality of governance and reflects a laudable commitment to equal access to fundamental services for all residents of Ontario. The extent and timing of fiscal redistribution (if it actually occurs) needs to be balanced against maintaining the relative economic health and competitiveness of the GTA economy.

*When compared with the rest of the Province and much of the country, the GTA has been disproportionately damaged by the recent economic recession.*

If the above mentioned perception does indeed reflect historical reality in Ontario, it should be noted that the continuation of such fiscal arrangements is dependent on the GTA remaining economically dynamic and internationally competitive — that the "engine" will remain well tuned. In light of the economic realities now facing the GTA — a sluggish economic recovery from an unprecedented recession — the GTCC has directed that the unproven perception

surrounding the fiscal role of the GTA in the Province be empirically investigated. To this end, three fundamental questions were posed through this study's terms of reference:

- Does the GTA supply the Province with more/less total revenues than it in turn receives back in the form of total expenditures?
- Does the GTA receive a larger/smaller allocation of municipal and education subsidies compared to the rest of the Province?
- Are property tax/user fee burdens in the GTA appreciably higher/lower than other regions of the Province?

## **2. The Economic Context: A Battered GTA**

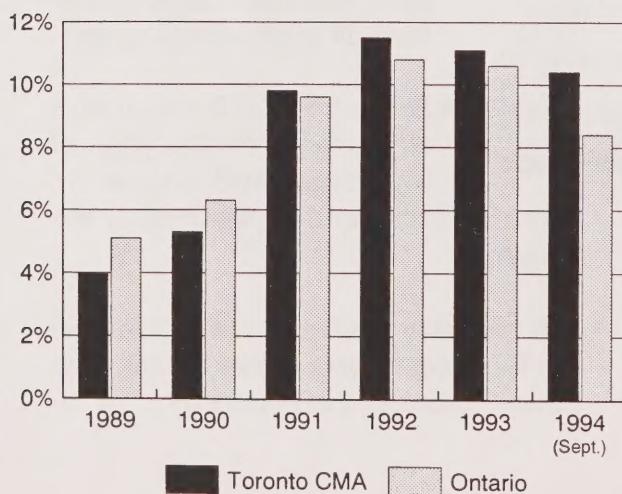
The decision by the GTCC to test perceptions about the fiscal role played by the GTA within the Province is firmly linked to the new economic and demographic realities facing the GTA.

When compared with the rest of the Province and much of the country, the GTA has been disproportionately damaged by the recent economic recession. The GTA experienced the highest loss of employment in Canada at the peak of the recession. The GTA unemployment rate has remained above 10 per cent for almost twice as long as during the previous recession. General Welfare Assistance cases per household were 34 per cent higher in the GTA in 1992 than in the rest of Ontario. Employment remains approximately 9 per cent lower than pre-recession levels. Bankruptcy growth rates have been higher than those in the rest of the Province. The unemployment rate comparison between the GTA and the rest of Ontario in Figure 1 pro-

vides one of many statistical "snapshots" indicative of the economic reality facing the GTA.

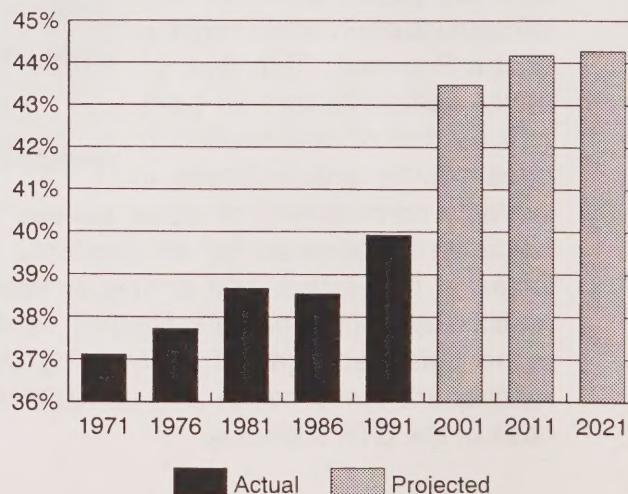
The economic damage inflicted on the GTA has taken place within the context of significant population growth and demographic pressures. Figure 2 illustrates that the GTA currently accounts for about 40 per cent of Ontario's population, and that its relative share of population is expected to grow over time. With population growth comes corresponding service and infrastructure pressures. Increasing demographic pressures arising from both the aging "baby boom" and school age "baby boom echo" segments of the population will exacerbate these service and infrastructure pressures across all GTA municipalities. Due to the role played by the L.B. Pearson International Airport as a major national port of entry, local social service, health and education service pressures will continue to grow across many GTA municipalities — unique pressures not found elsewhere in the Province.

**Unemployment Rate**



*Figure 1*

**GTA as Per Cent of  
Ontario Population**



*Figure 2*

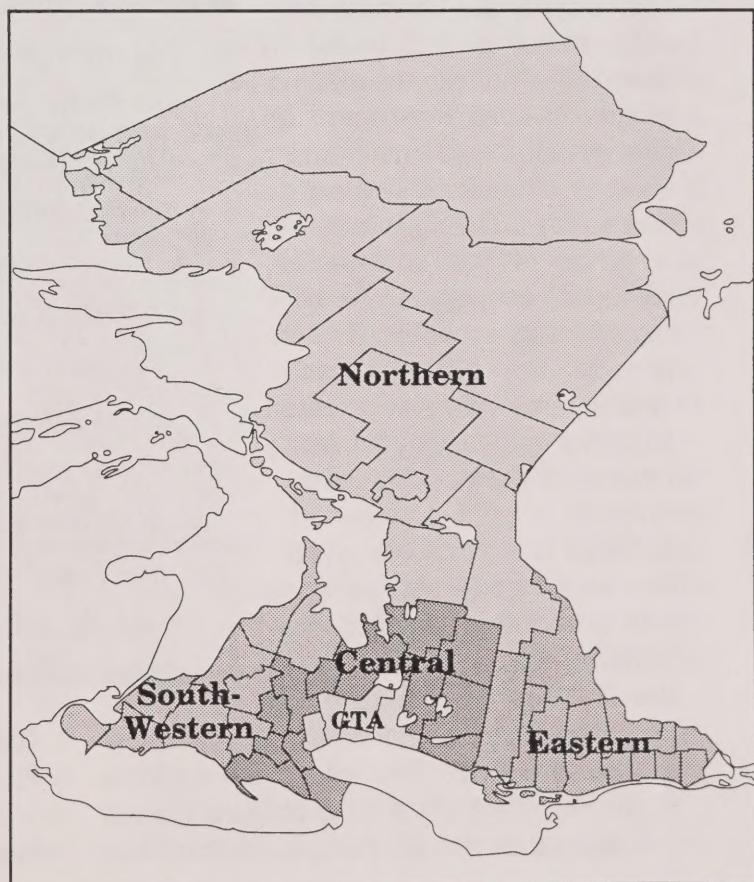
### **3. Study Components and Common Methodology**

The study consists of three basic components of work designed to answer the three fundamental questions posed by the GTCC in the terms of reference. The first component of work is referred to as an "Inflow/Outflow" analysis and it deals with the broadest research issue in the study — does the GTA supply the Province with more/less total revenues than it in turn receives back in the form of total expenditures? The second component of work is referred to as a "Subsidy Allocation" analysis. The Subsidy Allocation component seeks to compare levels of Provincial subsidy for municipal and education programs in the GTA with the rest of the Province. The third component of work is referred to as a "Tax Burden" analysis and it addresses the issue of comparative residential and non-residential property tax/ user fee burdens in the GTA and the rest of the Province.

The three study components feature certain common methodologies and data sources. Expenditure and subsidy data for approximately 830 Ontario municipalities, extracted from audited Financial Information Returns (FIRs), has been downloaded from the Ministry of Municipal Affairs (MARS) data base. Approximately 200 tables of analysis and statistical conclusions are presented at both a summary and detail level (eg. tax burden or subsidies are analyzed by major FIR categories such as transportation or environment). Non-municipal expenditure, subsidy and revenue data has been supplied or vetted by appropriate Provincial ministries (eg. education grants by Ministry of Education, Provincial revenues from Ministry of

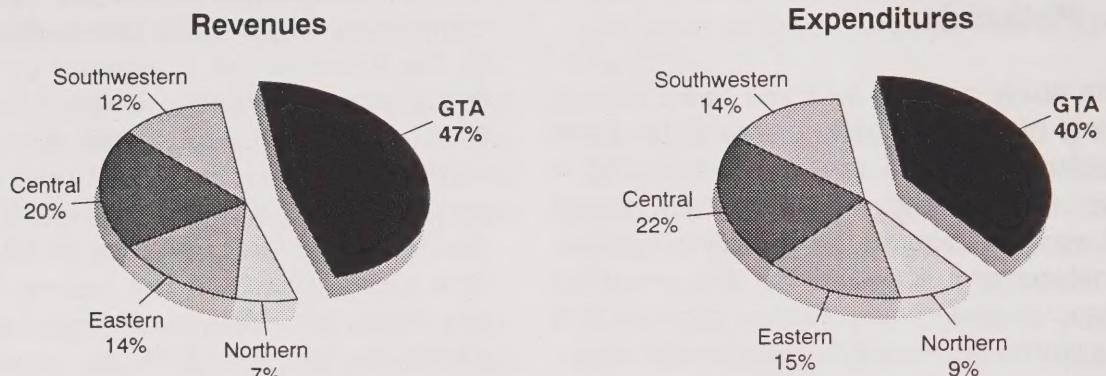
Finance budget documents). Virtually all comparisons between the GTA and the rest of the Province are presented on a per household basis to allow for population differences. Household count data for approximately 830 Ontario municipalities has been supplied by the Ministry of Finance. All study findings are presented using a 1988-92 time series analysis or the nearest equivalent Provincial fiscal year. Geographic comparisons of the GTA to the 800 municipalities in the rest of the Province are made on the basis of a sample series of selected municipalities, and by the four economic regions (Northern, Eastern, Central, Southwestern) used by the Ministry of Industry for economic development planning purposes. (see Figure 3)

**Economic Regions**



*Figure 3*

## 1992/93 Provincial Revenues and Expenditures



*Figure 4*

### **4. Inflow/Outflow Component - Methodology and Findings**

The objective of this study component is to measure the geographical distribution of Provincial government expenditures (eg. social services, health, education) and revenues (eg. personal income tax, corporate income tax, sales taxes, payroll taxes). In doing so a number of methodological issues needed to be addressed. While most major sources of revenue and expenditures were directly measured, a number of "hard to measure" residual revenues were estimated using economic data as proxies. For example, retail sales tax revenue was prorated by geographical region using retail sales data as the proxy.

A "Head Office" counting problem also needed to be dealt with in the study methodology. Taxes are usually remitted to the Province by a single office for corporations with widespread operations and sales outlets. This means the address of the remitting office of a corporation will not accurately reflect the geographic loca-

tion within the Province where taxes were actually earned. Revenues like sales taxes, corporate taxes, payroll taxes and gas taxes were redeployed (using proxy data) back to the geographic "point of payment" in order to avoid the "Head Office" concentration problem. A practical example drives the issue home: while a mining company with a GTA head office would ordinarily remit taxes "earned", this study redeploys tax revenues back to the Sudbury/Northern region "point of origin" and thereby avoids a revenue bias in favour of the GTA.

*...on a per  
household basis,  
the negative  
variance between  
GTA revenues  
contributed to the  
Province, and  
expenditures  
received, exceeded  
\$2000 in each of  
the five fiscal years  
analyzed.*

Finally, the annual Provincial budget deficit (in reality: a tax postponed to the future) needed to be geographically deployed as a revenue source. If the deficit was not deployed as a revenue source, all geographic comparators would have featured expenditures exceeding revenues.

The results of the inflow/outflow analysis are evident in Figure 4 and Figure 5. Figure 4 illustrates that in 1992-93 the GTA contributed 47 per cent of Provincial revenues while receiving

40 per cent of Provincial expenditures. Figure 5 demonstrates that, on a per household basis, the negative variance between GTA revenues contributed and expenditures received exceeded \$2000 in each of the five fiscal years analyzed. On a per household basis, the other four economic regions benefitted from a positive variance in the \$1000 to \$4000 range.

In 1992/93 the steadily widening negative variance for the GTA totalled \$3.7 billion or \$2,400 per household.

## **5. Subsidy Allocation Component - Methodology and Findings**

In attempting to compare municipal and education subsidy allocations, a key consideration was deciding exactly what constituted a subsidy. For instance, General Welfare Assistance (GWA) was deemed to be a universal prescriptive payment to individuals made jointly by the Province and municipalities. Virtually no geographic discretion is exercised in terms of GWA eligibility or benefit amounts. No obvious community economic benefits are derived from having high welfare payments/caseloads. Therefore, for practical analytical purposes GWA was deemed not to be a subsidy for purposes of the study. A second definitional issue around subsidies pertains to free municipal policing by the OPP. While no actual subsidy is paid to municipalities for such policing arrangements, a property tax supported expenditure is avoided and a "de facto" subsidy created. Unfortunately data is not available to quantify this implicit subsidy received by many small municipalities outside the GTA, and is therefore not included

*Provincial financial support for education in the GTA is by far the lowest among all Ontario economic regions.*

### **Who Benefits From The Province**

(\$000's per Household)

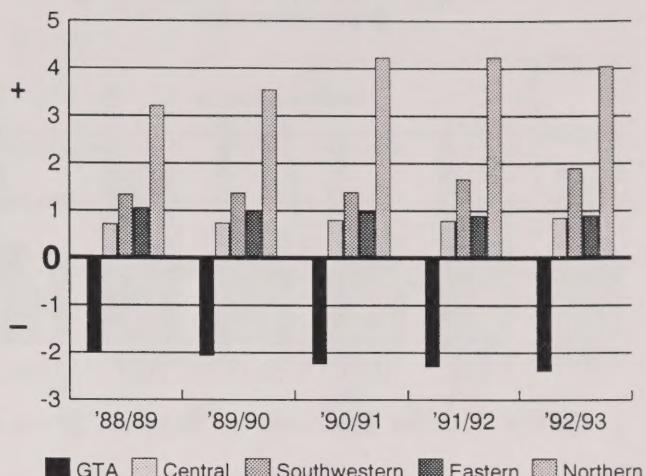


Figure 5

in the study. If included, free OPP policing would have increased subsidy per household totals for non-GTA economic regions but would not impact on the study's sample of large municipalities.

The results of the subsidy allocation analysis are evident in Figure 6 and Figure 7. Figure

6 demonstrates that municipal operating subsidies per household are skewed in favour of Northern Ontario and Eastern Ontario. It is also evident that the GTA receives lower-than-Provincial-average municipal operating subsidies per household. Figure 7 demonstrates that education subsidies per household in the GTA are by far the lowest among all geographic comparators. The 1992/93 education subsidy variance between the GTA and the next lowest regional comparator (Southwestern) is approximately \$780 per household.

The geographic variance in education subsidy allocation reflects the underlying philosophy of the existing General

## Provincial Operating Subsidies for Municipal Purposes – Excluding GWA

(\$ per Household)

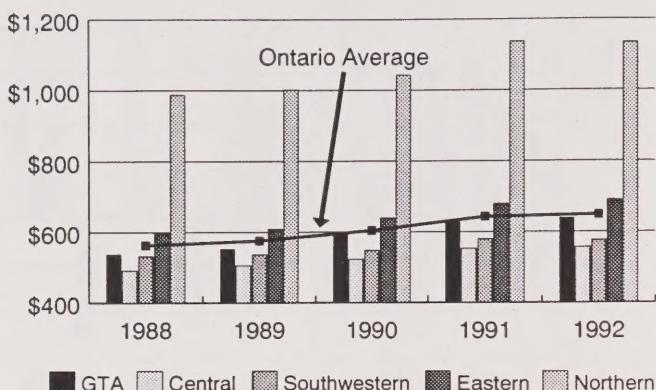


Figure 6

## Provincial Education Grants

(\$ per Household)

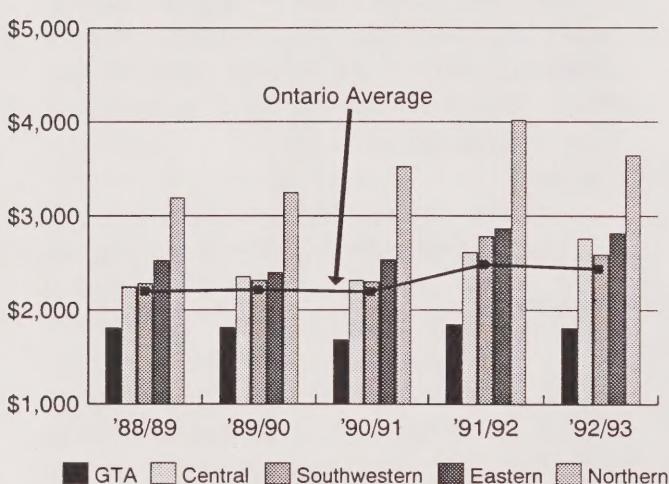


Figure 7

Legislative Grant (GLG) formula used by the Province. Under this formula the Province seeks to eliminate relative disparities in the ability of local school boards to finance recognized education service levels. School boards located within GTA municipalities receive smaller grants to support Provincially recognized education expenditures. It should be noted that this GLG formula produces a negative, and therefore zero, grant entitlement in Metro (for public schools) and that the formula is quickly eroding grant

entitlements for other GTA school boards outside of Metro.

The GLG formula has been criticized by the Fair Tax Commission (pages 605-610) for the following reasons:

- only 74 per cent of actual province-wide school board spending is included in the "recognized expenditure" standard that serves as the basis for each school board's grant — thus failing to consider unique education cost drivers found in a port of entry like the GTA;
- any formula trying to equalize school boards' ability to fund recognized service levels based on a comparison of property assessment will be flawed because assessment is simply a poor indicator of taxpayers' ability to pay.

## 6. Tax Burden Component – Methodology and Findings

The tax burden analysis is in fact a municipal expenditure burden analysis. Both property tax supported and user fee supported spending have been analyzed to ensure that common services (ie. sewer and water) were not excluded from the analysis because of differences in financing sources among municipalities. Residential tax/fee burdens (including Payments in Lieu revenues) are compared on a per household basis to ensure that appropriate linkages with subsidy allocation data can be made (ie. subsidy shortfalls translate into tax/fee increases). Non-residential tax burdens are compared on a per square foot basis. For the GTA non-residential comparator a tax/square foot was calculated using an arithmetic average of six arbitrary GTA locations. This has undoubtedly made non-resi-

## Residential Taxes and User Fees

(\$ per Household)

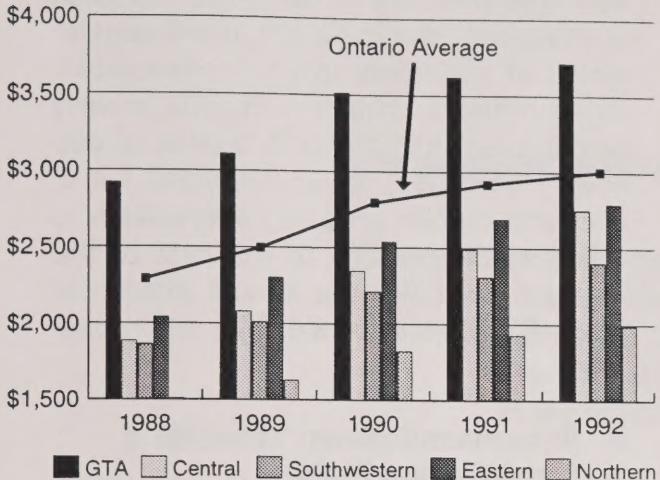


Figure 8

dential taxes in the GTA appear lower than they might have been if an alternative methodology had been available.

The results of the residential property tax/user fee comparison are displayed in Figure 8. GTA residential property tax/fee burdens per household are significantly higher than all other study comparators; higher by approximately \$1000 per household when compared to the next closest 1992 comparator - Eastern Ontario. This gap widens during the study's five year timeframe.

In theory, geographical variations in residential tax/fee burdens could be caused by any combination of the following three principal factors:

- differences in cost of service due to differing urban forms;
- differences in Provincial subsidy allocation and the resultant pressure on municipal taxes/fees;

## Total Tax Burden By Economic Region

1992

(\$ per Household)

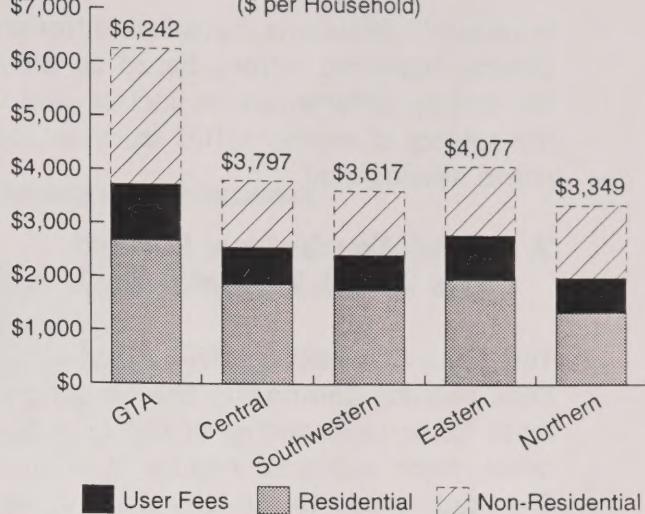


Figure 9

- differences in the amount and quality of service.

While the impact of urban form is not readily quantifiable, the subsidy allocation impact of education financing is quite apparent. Provincial education financing policy is resulting in a higher GTA property tax burden at a time when the GTA economy is undergoing difficult restructuring and is under considerable competitive pressure from both domestic and American rival jurisdictions. The differences in service levels are the subject of a parallel study being undertaken by the GTCC entitled "Quality of Life".

**GTA residential property tax/fee burdens per household are significantly higher than all other Ontario economic regions...**

The results of the non-residential tax/fee comparison are consistent with recently published studies showing relatively high GTA non-residential property tax burdens. Figure 9 illustrates that the total GTA tax/fee burden (including attributed non-residential taxes) is the highest in the Province. The question of whether, or to what extent, firms make

locational decisions between different Ontario economic regions based on these tax burden differentials is unclear and is the subject of another GTCC study on economic development.

## **7. Overall Conclusions: At What Price Wealth Redistribution?**

This study has yielded definitive and significant results comparing the Provincial-local fiscal relationship in the GTA and other major economic regions in Ontario. The study supports the long-standing perception that the GTA is in fact the "economic and fiscal engine" of Ontario.

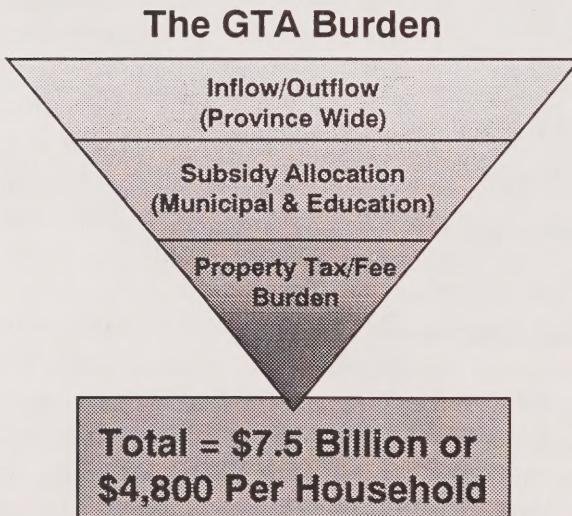
All available indicators show the GTA being hit hard by the effects of the recession and experiencing a hesitant recovery. The economic circumstances in the GTA, combined with demographic and population pressures, have resulted in reduced tax and fee revenues and higher expenditures for human services like education.

At a time when the GTA's economic health is marginal, the different treatment in terms of subsidy allocation is exacerbating a difficult problem. Trends clearly demonstrate that the GTA burden of outflowing revenues, lower Provincial subsidies and higher property taxes/fees is worsening in relation to the rest of the Province. In 1992 the annual differential totals \$7.5 billion or \$4,800 per household.

## **8. Recommendations: Towards a Level Playing Field**

In light of the study findings, the GTCC makes the following recommendations:

- That the Province take action to reduce the net outflow of revenues from the GTA;
- That the Province take action to rebalance the allocation of municipal subsidies towards the GTA in any future changes to overall levels of subsidy funding;
- That the Province re-examine the manner in which municipal subsidies are calculated;
- That the Province's review of education financing proceed as a top priority, and that reform recognize the unique population and demographic characteristics driving education costs and service levels in the GTA.



*Figure 10*

The staff and politicians of the GTA municipalities are available to work in partnership with the Ministry of Municipal Affairs and other appropriate Provincial decision-makers and staff towards resolution of these matters.

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**Greater Toronto Co-ordinating Committee (GTCC)**  
**Study Participants on**  
**"Rethinking the Fundamentals:**  
**Provincial-Local Finances**  
**in the Greater Toronto Area"**

The following individuals/organizations have contributed to the completion of this study:

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